

BRIBE, SWINDLE OR STEAL



Spotlight on Germany – Christian Schefold

[00:00:08] Welcome to the podcast Bribe, Swindle or Steal. I'm Alexandra Wrage, and today we're in Berlin to talk about the German enforcement and compliance landscape. My guest is Dr. Christian Schefold, who is a member of Dentons' corporate practice here in Berlin. Dentons is TRACE's partner law firm, and we're very grateful to you for your support. Prior to joining Dentons, Christian led the compliance consultation function at Daimler. Thank you for joining me.

[00:00:35] Thank you, Alexandra.

[00:00:36] I think in the anti-bribery community, at least, Germany is probably the best-known jurisdiction outside of the United States because of some of the very substantial cases that started here - not here in Berlin - but in the Munich prosecutor's office. Can you give us just a broad overview of enforcement in Germany?

[00:00:57] Unfortunately, Germany has a bit of a history of bribery. Until 1999, bribery outside of Germany and outside the European Communities was not sanctioned in a way, and it was supported because you could deduct this from your taxes.

[00:01:17] Sure, just as a business expense.

[00:01:18] As a business expense. When I started my professional career, I was told that when we go to East Europe, for example, that I should go to the accounting department upstairs, and they have a safe, and if I needed money to easier get passports, to get over control, to get things solved, just go there, and I would get up to a thousand marks, and I would go then and deal with the issue, for example, in Belarus or in other countries. This was a usual practice until 1999, after a lot of intervention of the OECD and political interventions. Germany decided, first, to stop the tax deduction and, very quickly thereafter, also to have this as a criminal offense. Of course, it was broadcasted. It was told. It was in the newspapers. Most companies had circulars where they were telling their sales people and everybody else that bribery now, even outside Germany and the European communities, are no longer admitted. Although these circulars existed, and you often see them in investigations, people did not really follow that. They continued with their business. There are very often companies who continued with this, maybe not in Germany directly because German tax authorities started to question any of these so-called useful expenses, but later on, they became more and more critical. From the Bavarian prosecutors, they approached directly companies like Siemens and MAN and started proceedings against them. However, before already the U.S. authorities went against German companies, and one of the examples is Daimler Chrysler - they had the SEC-DOJ investigation already in 2005, started one year before Siemens. That was the first German case where the German industry experienced that there are rules to follow, which they didn't obey themselves.

[00:03:30] I have the most interesting conversations with taxi drivers wherever I travel, and I recall that I was visiting Siemens' offices in Munich. I was in the taxi, and I asked the driver what he thought of the corruption scandal, and he said that it was clearly a political move by the Americans to put Siemens at a disadvantage in favor of General Electric. I'm curious if that's a widely held view in Germany.

[00:04:00] When the investigation started at Daimler, I was personally involved in coordinating the affairs. This was actually the thought of most of the employees at Daimler management. They said now, "Well, now they are trying to put us at a disadvantage. This is the punishment because we acquired Chrysler, so this is the political rollback we feared." So, yes, it was, but we very quickly experienced that this is not the case because we could see that there were a lot of American companies who were also under pressure from SEC and DOJ, so that this was not particularly something against Germans. However, we saw that there are differences in the application because we were cooperating with Japanese companies also listed at the U.S. stock market, which had the same practices. Obviously, authorities in the U.S. were not interested in their activities. There is a bit of selecting which jurisdiction to take and, as the European jurisdictions are closer to the American jurisdictions, I think they first want to tackle their threats because they want to have a Northern European-American alliance to stop this crime of bribery.

[00:05:23] It's always a little bit tricky because we don't have very much insight into the prosecutorial, decision-making process, and non-Americans will point to the top-10 largest penalties under the U.S. anti-bribery law - the FCPA - and point out that a majority of the top-10 for the size of the fine are non-American companies, but then the American response to that is the misconduct is more egregious outside of the United States just because American companies have had more time to get compliance programs into place. I suspect the truth lies somewhere in between, but again, we don't have a lot of insight into what evidence is available to any prosecutors when they start a case. Germany has this record, now, of going after its own companies for bribery overseas, but there was a flurry of these cases, and that seems to have slowed down. There haven't been as many cases recently.

[00:06:25] It can be that the situation has improved. On the other side, we really have to say from our consultation efforts that no medium-sized companies take a great effort to invest into compliance programs against bribery. Due to the Bavarian state attorneys, they were very successful in first dealing with the Siemens case. It was discovered by the Bavarian authorities, so it's not an American case like the Daimler case was - a whistleblowing case where an American employee from Chrysler turned to the Department of Labor in Michigan and told, actually, a story which was not true, however, was the start of a big investigation initiated by the U.S. authorities. The Siemens case was initiated in Germany. The MAN case was initiated in Germany and, as far as I know, because the MAN did not have any ties to the U.S. It was a pure German case and did not have any bigger scalings in the U.S. There had also been some other smaller cases in Germany, and I think the last one now being at the American authorities and with a monitor is Bilfinger. After that, actually, most German companies invested a lot into compliance programs to stop bribery.

[00:07:47] That's certainly our experience. We're talking to much smaller German companies that are taking this issue very seriously. In every country and every jurisdiction, it tends to start with the multinationals and then, partly because of their own efforts to push it down to their supply and marketing chain, it goes to smaller and smaller companies. But that evolution tends to take quite a long time, and in Germany, it's happened pretty briskly in my experience.

[00:08:12] Yeah, but also the Bilfinger case is a quite typical recourse. Bilfinger was a supplier to an American company, and the American company was first taken into irresponsibility, and then it was seen that one of the major bribery cases was initiated from a German company. That's what they fear. You are, of course, dependent on licenses, on business experience, on business connections to the U.S. What you do is you follow this to rescue and to save your own entity, your own enterprise.

[00:08:45] We're going to get to more positive matters in a moment, but to stay with the enforcement actions a little bit longer: The Volkswagen emissions scandal has received just extraordinary amounts of negative publicity worldwide. How has that impacted the compliance community here?

[00:09:04] It brings another aspect to compliance. In Europe, compliance was, at the beginning, anti-competition compliance, so if you had anti-competitive practices, this was due to the initiations, especially from the European Commission and their very effective competition department, and the extremely high fines. This was stopped because the philosophy behind that was that the European Commission was very successfully drawing down the borders between the different member states, and they should not be re-erected by commercial companies. That's where they looked forward and tried to remove any barriers. They invested a lot into competition cases, and they were very expensive in their penalties and their consequences. This is the first, I would say, wave of compliance. The second wave was definitely anti-bribery compliance. A third wave not that effective in that law and was export control and sanctions, especially because of the tensioning of the Iran sanctions, and now the Russian sanctions makes it very obvious that that's a compliance program needed. Now, technical features are coming to the compliance program, and one of the good cases there is, of course, the emissions scandal whereby in the public, the emissions scandal here in Germany is very often seen as a disadvantage of the German customers against the American customers because German customers do not get any damages that the Americans get, and that's actually a very interesting movement, not towards compliance, but to have equal chances for damages at court. That's a bit of a different sociological aspect.

[00:10:49] That's interesting. American owners of Volkswagens that were affected by the emissions scandal have been compensated, and nobody has in Germany - is that true?

[00:10:59] They're trying the first cases. A single case has been successful, but there is no class action, so everybody has to try their own way.

[00:11:07] Of course.

[00:11:08] The European Commission wants to change that. They want to open the possibility of class actions and make it possible that a lot of people were damaged receive a reward.

[00:11:20] A German company bears the penalties - for its own misconduct - but bears all of the penalties, which will have an impact on the German consumer, ultimately, in pricing and otherwise, and the American consumers are benefiting.

[00:11:37] What you just said is very interesting, actually. The issue is that the German customers and other European customers do not receive any damages, so you have the benefits of your misbehavior. It's still in the company. That's actually the function of disgorgement. For example, a big discussion in the legal sphere - for example, until recently, it was not common that companies being disadvantaged by anti-competitive behavior claim for damages. The German Railway Company, they started because they really were victims of incredible bribery and incredible anti-corruption and incredible anti-competition cases, so they asked for damages for this behavior, and they were successful in getting damages through. This actually will now challenge the size of penalties because the penalties do have a kind of punishment, but they also have a part of disgorgement so that you should not have any benefits. It's the argumentation of the European Commission to say that the penalties are so high because what they have to do is to disgorge the benefits. Now everybody is able to claim for damages. Then you do

not need high penalties anymore. This is something which is a very interesting development. We might see that penalties will go down, but they are for private actions of those people the victims would go on.

[00:13:14] Of course, in the United States, there is disgorgement by the company and propensity to class actions, so the company is then paying penalties. The shareholders are paying penalties twice, in that case, but I don't see a movement in the United States to conform those to limit either one.

[00:13:34] It's something which will really develop in the next years. We will see.

[00:13:38] You have talked previously about your first experience with due diligence.

[00:13:44] My first business partner, due diligence.

[00:13:46] Your first business partner, due diligence. That's a good point. It was just spectacularly bad. Talk us through that story.

[00:13:54] At the first country we took into account - Indonesia - and for the company I was working, we were looking at the dealers there and, of course, the principal dealers. We started to go down the list of the most important ones and the less important ones. We started with the most important ones in the capital of Indonesia, and we had the very, very first due diligence check. At that time, we used something like Google. I think Yahoo. We used other search machines which are not available anymore today and, suddenly, it appeared that the owner and the director of this dealership was a convicted murderer. We were very surprised about this, and we did reconfirm this with the law firm in Indonesia. It really turned out it was a son of a former dictator of Indonesia, and the person was really convicted of murder but somehow was able to escape prison and was still able to run a business and to run a substantial dealership in Jakarta. This experience, then, completely changed the attitude towards business partner due diligence. We immediately realized that this is very, very necessary to do, and we should have done this even earlier because if you're a German company offering your services and products in a country where it is in their language in the press that your main dealer is a convicted murderer and has a very powerful political past, this is not very good for your reputation. Apart from other things, that's something you really shouldn't want.

[00:15:42] Of course, it's probably not an indicator of a greater likelihood to engage in financial crime. I think critics would say that does not mean that he was more likely to pay bribes, but the reputational risk associated with partnering locally with a convicted murderer - I think that's about as extreme a reputational risk as we come across.

[00:16:07] And how did he manage to escape prison? I think that only works with bribery.

[00:16:14] Yes, and you've talked about how politically connected he was, who his father was. Now, you counsel companies that are doing business in Germany, whether they're German companies or foreign multinational companies. What do you tell them now that might be different from a few years ago? How have things changed when they come to talk to you about, for example, entering the German market for the first time?

[00:16:38] They should look for a good tax adviser, not for the tricks in tax but to do proper taxation because that's the information source of the German authorities to go into companies. Every company has a tax check every three years, and usually there's a lot of scrutiny in this tax check. If you are the first time there, they really look into your time and the way you're putting up the balance sheet and put up your accounts, and they have a lot of questions. Also, this first test should be carefully prepared by

German tax advisers to allow you to have good argumentation and to persuade them that you have a completely legal business.

[00:17:21] Every three years it's an automatic, on-the-ground audit of your taxes.

[00:17:26] The more automatic it is, the smaller you are, higher is the likelihood that you may escape. But it's something you have to take into account. There is this famous FlowTex case where a company was able to set up drilling machines in South Germany, and it turned out that never, ever drilling machine existed apart from one and only, which was a sample. The tax authorities actually did the tax check, and they found out that the whole business was fake, but they did not react. This was a liability case for the state of Baden-Wurttemberg. They were lucky they won the case, but it didn't look like winning from the beginning. There is the obligation of each tax person. If they find something which doesn't look sound, then they have to report this, and that's a reason why you have to be very, very careful with your tax declarations, with your accounting because if there's anything doubtful visible, it will be told to the police. It will be told to the state attorney.

[00:18:35] The tax review is the gateway for the German authorities to be in your offices and looking at your books and records. But what are the bribery risks in Germany? Germany is ranked 13th on the TRACE Matrix, so a very low likelihood of companies being shaken down for bribes, companies being asked for bribes. That's, of course, what the Matrix measures - not corruption generally. But if a company were to be asked for a bribe by a German government official, where is that likeliest to happen? Is it customs, permits, licenses at a very high level? Procurement?

[00:19:17] Very difficult to say. To be honest, I personally never have experienced that attempt to ask for bribe. We now have a case which is politically sensitive because it concerns refugees and their application for asylum, and it's alleged that lawyers invited the responsible civil servants for extensive meals. There's nothing very special, no high sums of money being paid, but you see that there is a high meals, and it was told by somebody who was watching this to the president of Lower Saxony - a very high level it went down - and it concerns the state of Bremen and the offices there. It's more likely not in the cities, not in the centers. It can be more than the remote spots, but extremely rare.

[00:20:14] Extremely rare. That's our understanding as well, and I think that's that sort of public perception. Perception can drive the number of demands as well, because if people come here imagining that it's a country with a high level of ease of doing business and low level of bribe demands, then they can gerd themselves accordingly.

[00:20:34] When you set up new business in Germany, where you really have to look at is the German culture of passing off, to look how the market is running and compliance to the law in the market. It's not actually done by the police. It's done by the competitors because other competitors may engage a law firm, screening the markets, screening their competitors for any violation of law, for any non-compliance. These lawyers can send a passing off letter telling them that they have discovered that they behave illegally, and if they are right, they are entitled to receive remuneration for this tip. That's a very widespread practice. It's a lot of small law firms and their money business. It's very important that, in the appearance, you are compliant with the applicable laws.

[00:21:28] That's an interesting point, and I think probably one that's quite unique to Germany. Just as we wrap up, perhaps you can respond to concerns that I hear from companies about the very rigorous data protection and privacy controls here in Germany. Europe, of course, is ahead of most of the world

on privacy issues, but Germany seems to take great pride in being at the front of the pack, even within Europe. Is that something that companies doing business here need to get up to speed on very quickly?

[00:22:03] Although the Germans are not the inventors of privacy - that's the Swedish. They had the first privacy law, but they somehow developed the privacy into a special ideological art of data protection and personal protection. The political issue behind this was an official count of the state, and people didn't want to provide a lot of information, so they went to the Constitutional Court in Germany, and the Constitutional Court invented the human right of self-determination of information.

[00:22:36] The human right of self-determination of information.

[00:22:39] Yes.

[00:22:39] That's very grand.

[00:22:40] Yeah, that's an incredible phrase, but it's actually not very bad because you should be able to determine who is using information about yourself.

[00:22:49] Yes.

[00:22:50] This is actually the story behind this. You're not the owner. You cannot become the owner of your information. You're not the owner of your data. That's a big political discussion and thoughts about changing ownership, but somehow, you should be able to steer your reputation. This was developed in 1973, even before modern communication was invented. The Internet was in its basics at this time, and it was just as a background that there was a census. The census was accelerating many Deiter. I can remember my father looking at the questionnaire and said, "They even want to know if my left toe was proper and in order. Why should they have this information?" So that's where it started. It somehow has become a kind of belief in privacy, which makes it very difficult to have useful and practical discussion about this. So many companies face vigorous fights of their customers, although their business models and their ideas are perfectly in line also with privacy standards. What we do recommend, actually, is to take a practical approach, look at the concerns and define a way - and this is also possible with the GDPR now - and define a way how to honestly look at their interests, look at your interests and find a way in between. That will make it successful, and if you have issues, you are perfectly invited to approach the supervising authorities. That's not a problem. They have to help you, actually, but you should be very careful how you approach because, depending on the approach - if you are aggressive and you have an aggressive model, they are very likely to reject. If you get on the cautious approach, and you first tell them that it's your aim to care for privacy, to care for the right of informational self-determination, and you have those models and you have this idea, then it's very likely that they will say, "OK, we think that's okay." Maybe you have to change this and that, but it's very likely that you go through, and with that, you have a perfect basic start. Even information technical business and having internet solutions for consumers will be successful.

[00:25:17] That's helpful. Thank you. TRACE has been spending a lot of time on this issue, of course, and the most striking thing to me across Europe - not just in Germany - is how little the two communities are communicating. The anti-bribery enforcement agencies and even the anti-bribery compliance professionals and the privacy enforcement agencies and the privacy compliance professionals are headed off in slightly different directions and completely siloed in their approach, and we need to figure out how to bring them both to the table to have a conversation that makes sense and advances the interests of both of them. But this has been very helpful, very interesting, and it is no hardship for me to

be in Berlin for a couple of days where you, of course are based full-time. Thank you so much for your time today, Christian, and for your support of TRACE as our partner firm in Germany.

[00:26:08] Thank you very much for your visit and for the opportunity to discuss these things with you, and we will hope and we really wish that TRACE has a successful future also in Germany.

[00:26:20] Thank you so much.